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VOLUME 39 NO. 24

FISCAL REPORT

PUBLICATION DATE: DECEMBER 6, 2019

Legislative Analyst Issues Positive But Cautious Outlook

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posted November 21, 2019

In its annual *Fiscal Outlook* released on November 20, 2019, the Legislative Analyst's Office (LAO) reports that the condition of the California economy and budget are stable, but cautions that the state may face headwinds in the near future.

Consistent with its recent approaches to forecasting California's economy, the LAO looks at the state's outlook through two lenses—a growth lens and a recession lens. Under an economic growth scenario, the LAO estimates state revenues to grow from $146 billion in 2019–20 to $167 billion in 2023–24. Conversely, in a recession scenario, the LAO predicts that the state could lose roughly $50 billion in revenue over the forecast period; due largely to declines in revenue generated by the personal income tax, which yields the lion's share of revenue from the state's "Big Three" taxes. Even in the face of significant revenue losses, the LAO estimates that reduced spending obligations in education and debt payments could save the state roughly $27 billion. The state could manage the remaining budget deficit and weather a recession by tapping into what is expected to be a $23 billion state reserve.

Noting that much of the risks to the state economy and budget are outside the control of state lawmakers, the LAO urges the Legislature to make judicious spending choices in the coming year. Though Analyst Gabriel Petek (Analyst) predicts that the state will enjoy a $7 billion surplus going into fiscal year 2020–21, he cautions lawmakers against committing more than $1 billion of the surplus to expanding programs or services and instead using it for one-time purposes.

Proposition 98: The Education Outlook

The LAO projects that the Proposition 98 minimum guarantee for 2020–21 will grow by $3.4 billion (nearly $2 billion from the General Fund and $1.4 billion from local property taxes) for a total of $84.3 billion. The Analyst also predicts that an additional $206 million will be available due to the expiration of one-time funded activities. Moreover, the LAO's revised estimates for fiscal year 2018–19 and the current year show that the state's obligated spending levels are $511 below the minimum guarantee, requiring a Proposition 98 settle-up payment that can be used for one-time spending purposes. After accounting for ongoing obligations between the K–12 and community college systems, like the cost-of-living adjustment (COLA) discussed later and a $350 million required deposit into the Proposition 98 rainy day fund, there will be approximately $2.1 billion for lawmakers to spend.

Budget Year 2020–21

While this may seem plentiful, the LAO notes that its revised estimate for the statutory COLA of 1.79% for 2020–21 is relatively low compared to the growing cost pressures districts face. Just over five months ago, the statutory COLA for 2020–21 was predicted to be 3.00%. A 1.79% COLA would yield $123 less on a per average daily attendance basis under the Local Control Funding Formula (LCFF) than a 3% COLA would have. This significant change in a key component of multi-year budgeting can have magnitudinous local impacts. Consequently, the LAO suggests that the Legislature may want to consider funding a higher COLA than is statutorily required, stating that a 0.5% increase to the COLA will cost the state $300 million for the LCFF and $38 million for community college apportionments. Other, more targeted investments that help districts defray costs to their general funds is another way to help districts manage their growing cost pressures such as paying down pension obligations that yield long-term returns or increasing special education funding for historically low-funded regions. Finally, the LAO advises the Legislature that investing in one-time activities provides latitude and helps to avoid future spending cuts in the event of an economic down turn.

Beyond the Budget Year

Like its broader report, the LAO forecasts Proposition 98 under a growth and recession scenario. As was alluded to previously, if the state were to fall into a recession, its education spending obligations would diminish significantly under Proposition 98. The LAO predicts that the minimum guarantee could fall by as much as $20 billion over the forecast period. Chillingly, the LAO warns that "the state not only would be unable to provide the COLA in 2021–22 and 2022–23, it would need to reduce spending, assuming it funds at the lower minimum guarantee." Furthermore, the Analyst further suggests that the state could open its old recession toolbox and that the "Legislature could [reduce spending] by making reductions to ongoing programs, deferring school and college payments, or exploring possible fund swaps."

For those of us who lived in the trenches of the Great Recession, terms like "deferrals" and program "reductions" are enough to have us running for the hills. Thus, we would hope that lawmakers would consider using other tools to mitigate the impacts of an economic downturn on our students, including using a portion of the state's reserve to avoid such draconian reductions to education spending.

Governor Gavin Newsom will issue his 2020–21 proposed State Budget on or by January 10, 2020. We look forward to seeing all of you at our Governor's Budget Workshops!